

Kerala State Backward Classes Development Corporation Limited
(Govt. of Kerala undertaking)

"SENTINEL", 2nd Floor, TC 27/588(7) & (8), Pattoor, Vanchiyoer PO

Thiruvananthapuram, Kerala - 695035

FRAUD RISK MANAGEMENT POLICY

Preamble

Preamble: In accordance with Reserve Bank of India's Master Direction on Fraud Risk Management in NBFCs vide notification no. RBI/DOS/2024-25/120 DOS.CO.FMG.SEC.No.7/23.04.001/2024-25 dated July 15th, 2024 Kerala State Backward Classes Development Corporation Limited (referred to as "KSBCDC or "the Company") hereby adopt and notify Fraud Risk Management Policy for KSBCDC with the aim of providing a frame work for prevention , early detection , timely reporting incidents of fraud to law enforcement agencies and Reserve Bank of India and matters connected therewith and incidental thereto

Chapter I

1. Short title and commencement

1.1 This policy may be called "Fraud Risk Management Policy for KSBCDC"

1.2 It shall come into force at once

2. Applicability

This policy is applicable to any instances of fraud, whether confirmed or suspected, involving employees, external agencies, and individuals having a business relationship with KSBCDC

3. Objectives of the Policy:

3.1 This policy aims to instill a proactive approach within the company for identifying, analyzing, and managing the risk of fraud. KSBCDC will maintain a zero-tolerance stance toward fraud across all levels and will implement measures to prevent fraud or potential fraud.

3.2 The policy is designed to achieve the following objectives:

- Establishing procedures and controls that facilitate early fraud detection and prevention.
- Providing guidance to the company employees on fraud prevention, identification and detection.
- Developing internal controls.
- Promptly documenting and timely reporting incidence of fraud to law enforcing Agencies and Reserve Bank of India
- Offering essential training to the company employees to enhance their awareness and capabilities in fraud prevention.

4. Actions constituting Fraud:

Fraud is defined as a deliberate act carried out by an individual through deception, suppression, cheating, or any other illegal means, leading to wrongful gain for oneself or others and causing wrongful loss to others. Examples of fraud shall include:

- Misappropriation of funds or assets and criminal breach of trust
- Fraudulent encashment through forged documents
- Manipulation of books of accounts or through fictitious accounts, and conversion of property;
- Cheating by concealment of facts with the intention to deceive any person and cheating by impersonation
- Forgery with the intention to commit fraud by making any false documents/electronic records
- Willful falsification, destruction, alteration, mutilation of any book, electronic record, paper, writing, valuable security or account with intent to defraud;
- Soliciting or accepting material benefits from customers or goods/service providers.
- Fraudulent cashing of forged instruments, manipulation of financial records, or using fictitious accounts.
- Unauthorized extension of credit for illicit gains.
- Negligence of duty leading to frauds.
- Cheating and documents forgery.
- Fraudulent transactions involving foreign exchange;
- Fraudulent electronic banking / digital payment related transactions committed on KSBCDC and
- Any other fraudulent activities not covered by the above categories.

Cases involving "negligence and cash shortages" or "irregularities" are treated as fraud if there is suspicion or proof of fraudulent intent.

Chapter II

5. Fraud Detection & Control and monitoring

5.1 Fraud detection involves identifying actual or potential instances of fraud. This can be accomplished through onsite inspections of processes, employees, documents, or by recognizing early warning signals.

6. Special Committee of the Board for monitoring and Follow up of Frauds

6.1 There shall be a special committee of the Board to be known as “Special Committee of the Board for monitoring and Follow up of Frauds (SCBMF)” constituted by the Board with the Managing Director and two independent Directors. The Committee shall be headed by one of the Independent Directors. The term of committee shall be two years and the Board may constitute a new committee after two years. Till the new committee is constituted the existing committee may hold the office till the new committee assumes office.

6.2 Functions of SCBMF

The major functions of the SCBMF shall be to:

- a) Oversee the effectiveness of the fraud risk management in the company.
- b) Identify the systemic lacunae, if any, that facilitated perpetration of the fraud and put in place measures to plug the same;
- c) Identify the reasons for delay in detection, if any, reporting to top management of the company.
- d) Monitor progress of CBI / Police Investigation, and recovery position a
- e) Ensure that staff accountability is examined at all levels in all the cases of frauds and staff side action, if required, is completed quickly without loss of time.
- f) Review the efficacy of the remedial action taken to prevent recurrence of frauds, such as, strengthening of internal controls.
- g) Put in place other measures considered relevant to strengthen preventive measures against frauds.
- h) review and monitor cases of frauds, including root cause analysis, and suggest mitigating measures for strengthening the internal controls, risk management framework and minimizing the incidence of frauds.
- i) Recommend to the Board suitable action to be taken against the perpetrators of fraud

6.3 Meetings of SCBMF

SCBMF shall meet as often as necessary, but at least one such meeting shall be held on every three months for review and monitor cases of frauds, including root cause analysis, and suggest mitigating measures for strengthening the internal controls, risk management framework and minimizing the incidence of frauds.

6.4 There shall be an internal Senior Management Level committee consisting of General Manager (Project) and General Manager (Recovery) who shall be responsible for implementation of Fraud Risk Management Policy approved by the Board. A periodic review of incidents of fraud shall also be placed before the Board / Audit Committee of Board (ACB) as appropriate by the Senior Management Committee

Chapter III

7. Frame work for Early Warning Signals for detection of Frauds

KSBCDC shall put in place a framework for Early Warning Signals (EWS) under the overall Fraud Risk Management policy approved by the Board through appropriate early warning indicators for monitoring credit facilities / loan accounts and other financial transactions. These indicators shall be reviewed periodically for their effectiveness. Suspicion of fraudulent activity thrown up by the presence of one or more EWS indicators shall alert /trigger deeper investigation from potential fraud angle and initiating preventive measures.

A Board Level Committee, similar to Risk Management Committee shall review the EWS framework for its suitable validation in accordance with its directions.

The framework shall cover the below mentioned parameters:

- EWS triggers and monitoring of the same,
- Remedial actions for the triggers.
- Periodic review of portfolio and control mechanisms.

The Early Warning Signals (EWS) can be from:

- a) Risk based calling: Carried out by Internal CRM team
- b) Pre-disbursement sample customer visits by Field Risk Officers
- c) Post Disbursement trigger based customer visits by Credit & Risk team
- d) Customer Complaints: Complaints from customers can trigger fraudulent practices
- e) Credit Monitoring: Unusual Portfolio Behavior indicating potential fraud
- f) Whistleblowers: Employees or insiders who notice suspicious activities can report them
- g) Audits: Regular audits can help detect irregularities or frauds
- h) Legal Actions: Legal proceedings or Litigation process can bring out fraudulent activities

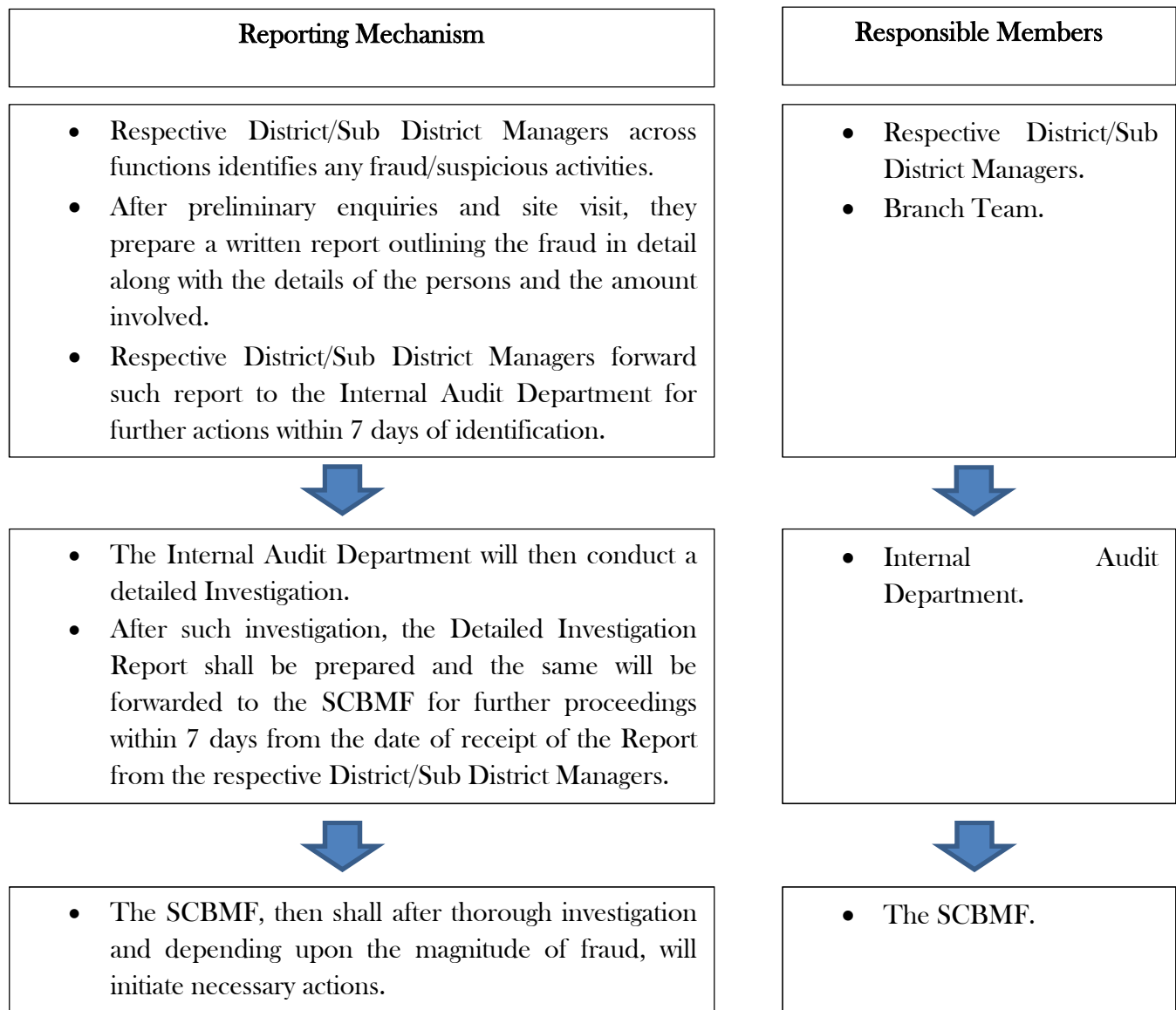
The frauds can be prevented by taking control measures as below:

- Performing thorough background checks and verifying documents of customers, and other business associates of KSBCDC Ltd.
- Internal audit of all loan transactions /credit facilities on regular basis
- Periodic training programs for all employees on real life scenarios, recent fraud cases and Fraud Detection & Prevention.
- Implementing preventive internal controls through appropriate process changes
- Reporting fraud to the Law Enforcement Agencies.

8. Fraud Monitoring and follow up :

KSBCDC Ltd shall set-up an appropriate organizational structure for institutionalization of fraud risk management within their overall Fraud risk management Policy.

The Risk Team, on periodic basis, shares Fraud reports, if any and dashboards with internal management and stakeholders. All potential fraud/suspected fraud shall be reported to the Internal Audit team and Board Sub Committee



9. Early Warning Signals (EWS) and Red Flagged Accounts (RFA)

A Red Flagged Account (RFA) is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the company on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent. The company cannot afford to ignore such EWS but must instead use them as a trigger to launch a detailed investigation into a RFA.

An illustrative list of some EWS is given for the guidance in **Annexure I** of this policy. District Managers/Sub district Managers may adopt or adapt the relevant signals from this list and also include other alerts/signals based on their experience, client profile and business models. The EWS so compiled would form the basis for classifying an account as a RFA.

A report on the RFA accounts shall be put up to the Internal Audit Department quarterly and the report should include a synopsis of the remedial action taken together with their current status.

The internal audit department shall put up the report on the RFA accounts to SCBMF.

Chapter IV

10. Credit facility/ loan account/ other Financial transactions -indication of fraudulent activities

10.1 KSBCDC shall monitor activities in credit facility/ loan account/ other financial transactions shall remain alert on such activities which would potentially turn out to be fraudulent

10.2 In case there is suspicion /indication of wrong doing activity KSBCDC shall avail the services of external audit for further investigation in such accounts

10.3 The external audit should cover aspects such as due diligence, competency and track record of the auditors, among others. External auditor shall complete the audit with in the time limit as approved by the Board.

10.4 The loan agreement with the Borrower shall contain clauses for conduct of audit on the behest of lender In case where the audit report remains inconclusive or is delayed due the non-cooperation of the Borrower , KSBCDC shall conclude that the status of account as fraud or otherwise based on the material available on the record or based on internal investigation / assessment in such cases

10.5 The principle of natural justice is strictly followed before classifying /declaring an account as fraud.

11. Staff Accountability:

In all fraud cases, staff accountability will be mandatorily explored. It is required to

- a) Confirm whether there was any lapse / mala-fide on part of employee which led to fraud and
- b) If so then to take action against the staff concerned.

KSBCDC Ltd shall put in place a transparent mechanism to ensure that Whistle Blower complaints on possible fraud cases / suspicious activities in accounts(s) are examined and concluded appropriately under Whistle Blower Policy.

KSBCDC Ltd shall conduct examination of staff accountability as per the guidelines issued by the Central Vigilance Commission (CVC) in terms of CVC order

12. Fraud Reporting:

KSBCDC Ltd shall issue a detailed Show Cause Notice (SCN) to the persons entities and its promoters, organizations, trustees, president, secretary, and persons who are in charge and responsible for the management of the affairs and promoters, as well as the executive directors and full-time employees, against whom the allegations of fraud are being examined. The Show Cause Notice shall capture the details about the transactions, acts, and occurrences which constitute the basis for the declaration and reporting of fraud.

Minimum of 21 days shall be provided to the Persons / Entities on whom the SCN was served to respond.

KSBCDC shall follow the principal of natural justice in a time bound manner for investigating the cases of fraud /suspected fraud

11. Reporting of cases of attempted fraud

District Managers/ Sub district Managers need not report cases of attempted frauds as and when they occur. However, a quarterly report on attempted frauds may be presented before the Internal Audit Department within 15 days from the end of the respective quarter. The report should cover the following:

- a) The modus of operandi of the attempted fraud.
- b) How the attempted fraud was identified.
- c) How the attempt did not materialize into fraud or how the attempt failed/ was foiled.
- d) The measures taken by the district/sub district office to strengthen the existing systems and controls.
- e) New systems and controls put in place in the area where fraud was attempted.

- f) What are the new measures to put in place to avoid such instances in future
- g) Whether this instance should be added to the Framework on Early Warning Signal

12. Reporting to the Board

In addition to the actions set out by the policy above, the SCBMF shall also notify the Board of Directors of the Company as follows:

- a) Information relating to frauds for the quarters ending March, June, September and December shall be placed before the Board of Directors during the subsequent month of the following quarter.
- b) Irrespective of the quantum, all instances of Fraud will be reported to the Managing Director.
- c) Where the quantum of the fraud exceeds Rs.1,00,000/- (Rupees One Lakh), the fraud shall be promptly reported to the Managing Director and Board after the same are proved in the preliminary investigation.
- d) It is to be ensured that information relating to all the attempted frauds involving Rs. 25 lakhs or more shall be placed before the Audit Committee of the Board (with details of fraud).
- e) In addition to the above, KSBCDC Ltd shall conduct an annual review of the frauds and place a note before the Board.

13. Reporting to RBI

Instances of Fraud shall be reported to RBI via RBI's CIMS Platform. Reporting requirements are as follows:

- a. FMR -1 for reporting new frauds of ₹1 lakh and above within three weeks (21 days) from the date of detection.
- b. FMR-3 for reporting the developments in respect of frauds already reported (as and when basis).
- c. FMR-4 (Quarterly Reporting of Theft, Robbery, Dacoit and Burglary): If there no incidents to report 'Nil' submission to be done, within 15 days from the reference date.

14. Reporting under Legal Governance

As a general rule, the following cases should invariably be referred to Law Enforcement Agency (LEA) viz state police authorities subject to applicable laws

- a) Cases of fraud involving an amount of ₹1 lakh and above, committed by outsiders on their own and/or with the connivance of staff/officers;
- b) Cases of fraud committed by employees, when it involves the KSBCDC Ltd.'s funds exceeding ₹10,000/-

Managing Director shall designate a Senior Level Manager for reporting incidents of fraud to LEAs and for proper co-ordination to meet the requirements of the LEAs

15. Fraud Governance:

Closure of Fraud

Prior approval from the respective Regional Offices of RBI/SSM Concerned is required for closure of fraud cases.

a) Statistical Closure

Fraud cases involving amount up to ₹25 lakhs, may be closed for limited statistical / reporting purposes where:

- the investigation is on, or challan / charge sheet not filed in the Court for more than three years from the date of filing of First Information Report (FIR) by the CBI / Police; or
- the trial in the courts, after filing of charge sheet / challan by CBI/Police, has not started, or is in progress.

b) Other Closure

KSBCDC Ltd shall close the fraud cases after completing all following actions:

- cases pending with CBI/Police/Court have been finally disposed of;
- the examination of staff accountability has been completed;
- the amount of fraud has been recovered or written off;
- insurance claim wherever applicable has been settled; and
- the systems and procedures have been reviewed, causative factors have been identified and lacunae plugged
- KSBCDC Ltd shall provide all possible assistance to the Police/CBI/Court for investigation/trial and vigorous follow up with the police authorities and / or court for final disposal of fraud cases shall be undertaken.

16. Powers of Board of Directors (BoD):

- BoD shall have the power to constitute/reconstitute SCBMF.
- BoD shall review this policy annually and necessary changes, if any, will be made in the policy after such review.

17. Enclosures:

Captioned RBI Master Direction on Fraud Risk Management in NBFCs dated July 15th, 2024.

18. Annexures

Annexure I - Early Warning Signals

Early Warning Signals

Some Early Warning Signals which should alert the District/Sub district Managers about some wrong doings in the loan accounts which may turn out to be fraudulent:

1. Continuous default in repayment of loan / bouncing of high value cheques
2. Under insured or over insured inventory
3. Invoices devoid of PAN/TAN and other details
4. Dispute on title of the collateral securities
5. Request received from the borrower to postpone the inspection of the warehouse for flimsy reasons
6. Same collateral charged to a number of lenders
7. Concealment of certain vital documents like master agreement, insurance coverage
8. Significant movements in inventory, disproportionately higher than the growth in turnover
9. Significant movements in receivables, disproportionately higher than the growth in turnover and increase in ageing of the receivables
10. Disproportionate increase in other current assets
11. Significant increase in working capital borrowing as percentage of turnover
12. Critical issues highlighted in the stock audit report
13. Increase in Fixed Assets, without corresponding increase in turnover (when project is implemented)
14. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet
15. Frequent request for general purpose loans
16. Non- routing of sales proceeds through bank
17. Original bills are from related parties of the borrower
18. Non submission of original bills
19. Lack of insurance for the assets acquired out of loans
20. Under valuation of collateral security